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C O N F I D E N T I A L SECTION 01 OF 03 TRIPOLI 001038

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E.O. 12958: DECL: 12/13/2017
TAGS: EPET BTIO ECON EINV ENRG LY
SUBJECT: LIBYAN EPSA GAS BIDDING ROUND: INTERNATIONAL MAJORS' INTEREST IS TEMPERED

REF: A) TRIPOLI 608, B) 06 TRIPOLI 775

CLASSIFIED BY: Chris Stevens, DCM, Embassy Tripoli, Department of State.
REASON: 1.4 (b), (d)

¶1. (C) Summary: Four companies won exploration and production rights for gas in the recently concluded fourth round of Libya's Exploration and Production Sharing Agreement (EPSA) mechanism. Winning bids featured low production sharing percentages for the international oil companies (IOC's), but in a departure from past rounds, only Shell offered a signing bonus as part of its winning bid. The National Oil Corporation (NOC) has publicly touted the results as being positive for Libya, but has privately conceded disappointment that more companies did not choose to bid. Opinions among IOC country managers in Libya differed as to the takeaway from this round. Some argued that the small number of bids signaled to the NOC dissatisfaction with increasingly stringent terms and operating conditions. Others maintained that the fact that terms for EPSA IV winners were consistent with previous rounds has reinforced the NOC's belief that -- despite grumbling -- IOC's remain willing to absorb thin production sharing margins and, in some cases, pay hefty signing bonuses to secure access and book reserves. End summary.

THE PLAYERS ...

¶2. (U) As forecast in ref A, Libya's National Oil Corporation (NOC) Organizing & Supervising Committee hosted an event December 9 at Tripoli's al-Mahari Hotel to announce results of recent bids for exploration and production sharing agreements (EPSA's) for onshore and offshore parcels. The event represented the fourth in a series of EPSA bid rounds (EPSA IV) held since August 2004; it was the first to focus on natural gas. According to the U.S. Energy Information Administration, Libya has some 52 trillion cubic feet of proven gas reserves, fourth among all African countries. A dozen parcels comprising 41 separate blocks of territory were offered for bidding and generated 19 offers by 13 companies (from 11 different countries) for 10 of the 12 parcels. 35 companies had been pre-selected to bid for the contracts; only 19 chose to do so.

¶3. (C) Two offshore parcels comprising eight blocks only received bids by single companies; under the terms of the EPSA, the bids were not opened and will be examined privately by the NOC's management committee to determine whether they will be accepted. ExxonMobil Country Manager Phil Goss (protect) judged that significant projected exploration costs for the offshore areas (up to $100 million per test well) and tricky technical requirements (water as deep as 3,000 meters) that few companies have the ability to manage deterred most from bidding on offshore blocks.

... THE ACTION

¶4. (U) Four potentially lucrative gas EPSA contracts were awarded to Gazprom, Sonatrach, Shell and Polskie Gornictwo Naftowe i Gazownictwo (Polski). Russia's Gazprom beat back a competitive offer from French company Gaz de France for three blocks (area 64) comprising 3,936 square kilometers in the southern Ghadames basin. Despite earlier statements to the press by a Gaz de France official that the company was "very keen" to establish a presence in Libya, Gazprom's willingness to take a significantly smaller percentage of eventual production carried the day. Gazprom's commitments per its bid are: 1,500 square kilometers 2-D seismic imagery; 250 square kilometers 3-D seismic imagery, 4 wells, no signing bonus and a 9.8% share of gas produced. Gaz de France offered more seismic imagery and wells, but asked for a production allocation of 16.8%. Other bidders on area 64 were Polski, Japan's Inpex, Lukoil, British Gas and the Pakistan Oil and Gas Company.

¶5. (U) Algerian parastatal Sonatrach, in assocation with Oil India, won rights to four blocks (areas 95 and 96) comprising 6,934 square kilometers in the Ghadames area. Sonatrach's commitments per its bid are: 2,000 square kilometers 2-D seismic imagery, 600 square kilometers 3-D seismic imagery, 5 wells, no

signing bonus and a 13.0% share of gas produced. Germany's RWE submitted a strong bid that included 11 wells, but asked for a 19.0% production share. Other bidders were Gaz de France, Polski and British Gas.

¶6. (U) Anglo-Dutch Shell Company won two blocks (Area 89) comprising 1,790 square kilometers in the northern Sirte Basin. Shell's was the only bid on the day that carried a signing bonus, in the amount of $93 million, for the NOC. (Note: Next to production share, signing bonuses are the most heavily-weighted factor in a given bid. End note.) Shell's commitments per its bid are: 0 square kilometers of 2-D seismic imagery; 740 square kilometers of 3-D seismic imagery; 4 wells; USD 93 million signing bonus and a 15.0% share of gas produced. Other bidders were Sonatrach and PetroCanada.

¶7. (U) Polski won two blocks (area 113) in the southern Murzak Basin with a bid that committed it to the following: 0 square kilometers 2-D seismic imagery; 1,500 square kilometers 3-D seismic imagery; 4 wells, no signing bonus and an 11.8% share of gas produced. The other bidder was Gaz de France.

NOC PUBLICLY POSITIVE, PRIVATELY "A BIT DISAPPOINTED"

¶8. (C) Winning bid terms echoed those for the EPSA III round in December 2006 (ref B), with low production shares weighted heavily in the calculus for awarding points to each bid. Publicly, the NOC is touting the favorable terms of the four winners, with an emphasis on the high percentage of eventual production that will go to Libya. Privately, NOC Chairman Shukhri Ghanem told visiting Verenex Energy (Canada) CEO Jim McFarland (protect) December 11 that he was "a bit disappointed" that more companies had not chosen to bid. Ghanem subsequently told executives from Algeria's parastatal Sonatrach that the NOC, discouraged by the tempered ESPA IV bidding, will "take a break" from organizing further EPSA bid rounds. Ghanem's thinking, according to Sonatrach, is to allow time for production in parcels contracted in previous rounds to kick in. By allowing Libya's market to "settle" a bit, the NOC hopes to

whet IOCs' appetite for further contracts.

MARGINS REMAIN TIGHT

¶9. (C) By contrast with earlier bid rounds, which featured hefty signing bonuses in addition to razor-thin production sharing margins of as little as 6.8%, no company save for Shell offered signing bonuses for EPSA IV gas contracts. BP Country Manager Tawfiq Hussein (protect) attributed that to the increased difficulty of realizing profitability under increasingly stringent EPSA terms, and to the fact that "the bloom has come off the rose a bit" with respect to the Libyan oil and gas market. Woodside Exploration Manager Sean Guest noted that low production sharing margins were critical in determining winning EPSA IV bids. Stringent terms, low production shares and lingering concerns about the difficulty of operating in Libya (visas and expat staffing remain significant problems) have given some pause. In addition, Libya's limited gas export infrastructure and the lack of clarity about whether EPSA IV winners will be able to exploit oil reserves discovered while searching for gas tempered enthusiasm. Marathon's Country Manager, Freddie Quintana (protect), told P/E Chief that the EPSA IV round was "a particularly difficult one" in which to bid because gas pricing is more complex than oil pricing and because Libya's gas export infrastructure remains limited.

MIXED SIGNALS

¶10. (C) Opinions differed at a meeting of IOC country managers December 12 as to the summary judgment of the EPSA IV round. Some argued that the relatively limited number of bids constituted a message to the NOC that increasingly stringent terms and difficult operating conditions would discourage bids. Others maintained that contract terms for bid winners were consistent with previous bid rounds, confirming the NOC's belief that IOC's remain willing to take thin production sharing margins and, in Shell's case, pay hefty bonuses to gain access.

¶11. (C) Comment: Media reports have interpreted the EPSA IV

round results as a sign of diminished interest by IOC's in Libya's hydrocarbon sector in general, and in the gas end of the business in particular; however, the four winners (Gazprom, Sonatrach, Shell and Polski) are all major companies and proven gas producers. Although the latest EPSA round failed to attract as many bids as the NOC would have liked, the fact that serious first and high-second tier companies ultimately bid and won potentially augurs well for efficient exploitation of Libya's gas reserves, although serious investment in gas export infrastructure is needed. The broader message from this round is that while IOC's are still keen to establish a presence and book reserves, they are increasingly reluctant to pay large signing bonuses up-front to do so. End comment.

Shell only major IOC; Polski, Gazprom, Sonatrach reflect EPSA III results and trend towards highest bid despite quality of operator (for EPSA rounds); GOL has recently concluded non-EPSA contracts with BP and Exxon Mobil (reftel), and extended contracts with Eni and PetroCanada to lend some balance to mix.
MILAM